

PAYMENT ISSUES – THE PROBLEMS OF MALAYSIAN
CONSTRUCTION INDUSTRY

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Thesis submitted in fulfillment of the requirements for the award of the degree of
Bachelor of Engineering (Hons) in Civil Engineering

Faculty of Civil Engineering & Earth Resources

UNIVERSITI MALAYSIA PAHANG

JUNE 2015

ABSTRACT

The construction industry plays an important role in Malaysia development process. The industry establishes buildings and infrastructure works required for social economic development which contribute to the overall economic growth. However, there remains a chronic problem of delayed and non-payment in the Malaysian construction industry affecting the entire delivery chain. However, there remains a chronic problem of delayed and non-payment in the Malaysian construction industry affecting the entire delivery chain. This research therefore set out to study the profiles of Malaysian court cases in relation to payment disputes in construction industry. The research is also to address the legal issues in relation to payment disputes based on the court cases also to investigate the problem, effects and legal issues disputed by contractor together to provide remedies of payment in construction industry. The result shows that payment has been an issue of major concern in the construction industry. As consequences, the payment due is postponed until the resolution of the dispute. The result shows that payment has been an issue of major concern in the construction industry. It really giving stress to contractor as it creates the cash flow problem. It also reflects the inadequacies and shortfalls of litigation process which take a long duration to determine the dispute. As consequences, the payment due is postponed until the resolution of the dispute. In summary, findings of this research may assist the relevant parties in addressing problems associated to late and non-payment in an effective and timely manner to create a win-win situation for all parties in the Malaysian construction industry.

TRANSLATION OF ABSTRACT

Industri pembinaan memainkan peranan yang penting dalam proses pembangunan Malaysia. Industri ini menyediakan bangunan dan infrastruktur yang diperlukan untuk pembangunan sosio-ekonomi yang menyumbang kepada pembangunan ekonomi secara keseluruhan. Namun begitu, situasi ini masih dalam keadaan kronik disebabkan oleh isu kelewatan dan ketidakbayaran di Malaysia yang mengganggu keseluruhan rantai pembayaran tersebut. Penyelidikan ini adalah bertujuan untuk mengkaji profil kes-kes mahkamah di Malaysia yang berkaitan dengan masalah pembayaran di dalam industri pembinaan. Selain itu, penyelidikan ini juga untuk mengemukakan isu-isu undang-undang yang berkaitan dengan industri pembinaan berdasarkan kepada kes-kes mahkamah. Penyelidikan ini juga bertujuan untuk mengkaji masalah dan kesan keatas kontraktor selain menyediakan jalan penyelesaian bagi isu pembayaran. Keputusan daripada penyelidikan ini menunjukkan bahawa isu bayaran merupakan satu isu yang dititikberatkan dalam industri pembinaan. Masalah ini membuatkan kontraktor berasa tertekan kerana ini akan menyebabkan masalah pembayaran. Ini termasuklah ketidakpuasan terhadap proses mahkamah yang mengambil masa yang lama untuk menyelesaikan kes-kes tersebut. Keadaan ini menyebabkan kontraktor mengalami masalah kewangan yang berterusan. Secara kesimpulan, keputusan dari penyelidikan ini dapat membantu pihak-pihak yang berkenaan dalam mengenal pasti masalah-masalah yang berkaitan dengan kelewatan dan ketidakbayaran dan mengatasinya dalam keadaan yang lebih efektif dalam masa yang singkat untuk memberikan keputusan yang sama rata kepada semua pihak dalam industri pembinaan.

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LIST OF ABBREVIATIONS

AC	Appeal Cases
AIR	All India Reports
Bing	Bingham Reports
BLR	British Law Reports
CIDB	Construction Development Industry Board
Con LR	Construction Law Reports
ISM	Institute Of Surveyor Malaysia
MBAM	Master Builders Association Malaysia
MC	Malayan Cases
MLJ	Malaysian Law Journal
PAM	Pertubuhan Arkitek Malaysia
PWD	Public Work Department

CHAPTER 1

INTRODUCTION

1.1 Background of Study

The construction industry plays the important role and key sector in the development that contributes to Malaysia's economy growth. The nation's economic system has shown encouraging trends for the first quarter of 2014, where the Gross Domestic Product (GDP) recorded a growth of 6.2%, which is the highest increase since the fourth-quarter of 2012. It is because the construction industry remains robust and recorded double digit growth of 18.9% (Martin C., 2014). The success of economic development will further lead to an increase in incomes, generating demand for additional construction activities.

The industry also provides employment for many ranging from professional such as architects, engineers and surveyors to main contractors, subcontractors, suppliers and ultimately manual laborers who are hired by these contractors. The construction industry is an important cog in the wheel propelling the Malaysia economy (M. Fikri et al., 2012).

The Malaysia Construction Industry Master Plan (CIMP) (2005 – 2015) has a vision for the Malaysia Construction Industry to be WORLD CLASS by 2015. Outlined with the CIMP are the vision, mission, critical success factors, seven (7) strategic thrusts and twenty one (21) strategic recommendations that will guide the development of the Malaysian Construction Industry through the following decade.

Focusing on strategic thrust No.2, it is aimed to strengthen the construction industry image. It is recommended that an Act be enacted to address non-payment, late payment and other payment related issues in the construction industry (M. Fikri, et al., 2012). Therefore, Construction Industry Development Board (CIDB) Malaysia in collaboration with the construction industry has moved forward for the enactment of Construction Industry Payment and Adjudication Act to improve cash flow problem in the Malaysian construction industry.

1.2 Problem Statement

Payment has been said to be the life-blood of the construction industry. Yet there remains a continuing problem of delayed and non-payment in the Malaysian construction industry calling for the entire delivery chain (Noushad, 2005). It is generally accepted that the late or non-payment will cause severe cash flow problems especially to contractor (M. Fikri et al., 2012). However, the construction industry is always in dispute liable. It is therefore common for the claimant pursuing his claim for works and services rendered to meet with a cross claim instead for defective work, delayed completion etc. Thus payment is always postponed until the settlement of the conflict (Lim, 2005).

The usual mechanisms for dispute resolution in the Malaysian construction industry are presently by way of arbitration and litigation. These mechanisms have always involved the judicial system and a complex body of rules as to the process. It is no secret that these mechanisms of dispute resolution leave much to be trusted. Criticisms are frequently made as to its many inadequacies and shortfalls. Litigation is affordable but it takes too long. It may be heard after a long delay by a judge with little or no experience in the field of construction (Sundra, 2003). On the other hand, arbitrator is faster but it is expensive. In any case, both modes will still take a considerable length of time as the disputes will have to be determined and disposed in accordance with the law, which must amongst others require affording the disputant natural justice in the presentation of their respective case (Lim, 2002).

The situation is getting worse when there are only limited security of payment and remedies pending dispute resolution for the unpaid claimant in Malaysia. In *Kah Seng Construction Sdn Bhd v Selsin Development Sdn Bhd* (1997) 1 CLJ Supplemental 448, there is no general common law right of suspension of work for non-payment. The unpaid claimant is given with the option of getting on with the work concurrent suing for payment with interest or if the non-payment is thus severe to constitute a repudiator breach, and so there is the option terminating the contract.

There can be multitude of reasons for the dispute ranging from under capitalization of the respondent to in-competency of the claimant. Even though, standard forms such as PAM 1998 and CIDB 2000 contain express provisions for determination of employment. However as matter of practice, many unpaid claimants are reluctant to go on the route of determination of employment (Lim, 2005). These are the dilemmas of the unpaid contractor as its cost flow and profitability are often in put in failure.

1.3 Objectives of the Study

The objectives of this research are:

- a. To determine the profiles of Malaysian court cases in relation to payment disputes in construction industry which are most likely brought to the court.
- b. To investigate the problem, effects and legal issues disputed by contractors.
- c. To provide remedies or solution of payment in construction industry.

1.4 Scope of the Study

The study is involves the class A construction company. The study only covers during the construction phase and not in bidding and design phase.

1.5 Significant of Study

The multitudes of difficulties associated with payment are generally faced by all participants in construction industry: main contractor, sub-contractor and professionals. Therefore, it is strongly believed that the topic area of this research would provide both personal interest and be beneficial to the participants in the construction industry.

This research should increase the awareness of both contractors and employers in relation to the payment issues. It will also provide the contractors with a better understanding of their rights to payment and their legal position if payment is in default. The research is also expected to grab the attention of the employers in making their payments promptly and timeliness. This will lead to improved working relationship between the contractors and employers.

This study addresses the current problems in relation to late and non-payment issues encountered by contractors in the local construction industry. Findings of this study may assist the relevant parties in addressing problems associated to late and non-payment in an effective and timely manner to create a win-win situation for all parties in the Malaysian construction industry.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

The Malaysian construction industry is one of the biggest industries in this state. It accounts for around RM 40 billion worth of production. It represents 5% of the Malaysia gross domestic product (Fadhlin, 2004). It employs a workforce of about 2 million people and it engages support services from a wide range of skilled professional from architects to engineers, from arbitrators to quantity surveyors, from accountant to lawyers. Also, it produces some of the best examples of engineering and building work in the world like Kuala Lumpur Twin Tower, Kuala Lumpur International Airport and Sepang Formula One Circuit.

However, it is common to find that the problems of contractors on the shortcomings of the payment regime in the Malaysian construction industry as reported in the press. Nevertheless, such practices were never an issue during good times when jobs were aplenty and many contractors or even sub-contractors will tolerate late payments or even part payments. However these problems will magnify when the construction industry is deeply scathed by bleak market sentiments and falling construction demand (Lip, 2006).

2.1.1 Problems Associated with Payment in Construction Industry

Over many decades, there has been a multitude of industry epithets about the relationship between the construction industry and its many varied payment procedures. Payment and cash flow are the life blood of the industry; there are fundamental to the process of construction, they are the root of many of its problems (Pettigrew, 2005).

Payment problems are an old age issue that has been spread in Malaysian construction industry over the long time (Siti and Rosli, 2010).

Banwell Report (Banwell, 1964), Sir Harold Banwell commented that: “*The operation of the payment system is not always smooth. Payment to the main contractor by the clients is often slow and uneven, with consequential delays in payments to suppliers and subcontractors. This has an adverse effect on the efficiency and stability of the whole industry.... What is needed is an agreed procedure to ensure that payments are made regularly and promptly.*”

In 1993, a report entitled *Trust and Money* by Sir Michael Latham revealed that payment difficulties featured largely. The fears of contractors and specialist contractors about payment were clearly identified with the available evidence showing an industry supply chain wracked with internecine where payment abuse was the inevitable battleground. (Latham, 1993) It reported that: “*Contractor worry that they will not be properly paid by clients, either because the employer will fail financially, or because the certified monthly payments will not properly reflect what they believe to be the true value of the work carried out.*”

In 1994 , Sir Michael Latham, in his report – *Constructing the Team* (Latham,2003), it was observed that: “*The cascade system of payment in the industry – normally client to main contractor, main contractor to subcontractor, and so on down the chain – makes the exposure of different parts of the process to the insolvency of one participant particular serious.*”

In 2004, a survey of payment performance conducted in UK revealed that construction is clearly at the lower end of payment periods with payment taking on average 56.51 days after invoices or applications for payment have been rendered (Experian, 2003).

In the local scene, many complaints have been voiced about the events of late and non-payments but the information has been mainly in the form of hearsays whether there

really is a problem on payment in the Malaysian construction industry.

A survey was conducted by Master Builders Association of Malaysia (MBAM) among its members who comprised of contractors and sub-contractors (MBAM, 2005). It was about 80.3% indicated that they had encountered slow progress payment. The respondents who encountered difficulties in getting progress payment were involved equally in public and private sector's projects. The survey also showed that the contractors are facing delay of payment for more than 91 days and up to 12 months compared to the contractual date. In summary, the analysis revealed that the issue of late and non-payment has persisted in the Malaysia construction industry for quite some now, but have yet to be fully resolved.

Just recently, Construction Industry Development Board (CIDB) Malaysia also conducted a survey on late and non-payment to address the current problems in relation to late and non-payment issues encountered by main contractor, sub-contractors and consultants in the local industry (CIDB, 2006). The survey was conducted on two sets of construction players, namely the contractors and the consultants. 44.1% of the contractors reported that they had encountered late payment situations in government funded projects while 53.5% had experienced late payment in private funded project. About 14.4% of the indicated that they had experienced non-payment situation in government funded projects and 33.3% pointed out they had not been paid by their private clients.

It was evident that consultants have also faced similar difficulties in getting their professional fees. Based on the consultant's responses, 63.3% and 73.5% reported that they had encountered late payment of professional fess in government funded projects and private funded projects respectively. Also, 16.3% indicated that they had experienced non-payment of fees in government funded projects while 61.2% reported that they had not been paid for the services rendered by their private clients.

In addition of that, CIDB Working Group (WG) Report on Payment reported that it appears 100% consensus that payment and related issues are considered to be a problem in

the construction industry. In short, problems on payment range from (Noushad, 2004):

- a. Failure to pay
- b. Refusal to pay
- c. Setting-off from sums certified or due
- d. Allegations of under and over certifications and failure to certify
- e. Delayed payments
- f. Associated problems of getting paid even with certificates in hand including significant delays in enforcing rights to payment

2.1.2 Causes of Payment-Default in Construction Industry

The route to understanding the inherent difficulties over payment lies in identifying the many complex factors that are present in the industry. Based on the research conducted by Construction Industry Development Board (CIDB) Malaysia, both contractors and consultants have agreed that the most frequent causes of late and non-payment, the study includes are (CIDB, 2006):

- a. Paymaster's poor financial management

According to Abdul Rahman et al. (2009) poor financial management is one of the causes of late and non – payment. Based on the research done by Hasmori et al. (2012), the factors in paymaster's poor financial management are:

- Deficiency in client's management capacity
- Lack of proper process implementation
- Bankruptcy or winding up of paymaster other business activity
- Client's need money to roll

b. Paymaster's withholding of payment

Based on the research done by Yee and Abdul Rahman (2010), identified clients delay for their own financial advantages, delay in releasing of the retention money to contractor and willful withholding of the payment for personal reasons are the cause of paymaster's withholding of payment.

c. Local culture/attitude

The research by Yee and Abdul Rahman (2010), contractors in Malaysia perceived that delay for few days less than 5 working days is acceptable and accepted late payment from the clients.

d. Conflict among the parties involved

Based on Hasnori et al. (2012), they indicated that payment not unexpectedly, has always been in the main subjects of disputes. It is anticipated that conflict if unsettle will escalate into dispute which can also cause late and non – payment.

e. Contractor's default

Based on result analysis by Yee and Abdul Rahman (2010), delay in certification by parties involve in the project might also cause of late payment issues. The parties involve may delay in approving the application for payment claim due to certain reasons which may arise because of his own or other parties involve.

f. Contractor's work performance

Mohamad et al. (2012) indicated that contractors fail to agree with the valuation of work at site. This would then result in conflicts between clients and contractor and the claims would not be certified and consequently, late payment occurred. Undoubtedly, the process of construction is complicated and fragmented. It involves many different commercial parties operating in supply chain under a range of contractual arrangements where risks are devolved throughout the supply chain (Pettigrew, 2005).

Malaysian construction industry is made up of large numbers of small and medium sized enterprises and a small number of dominant companies. The hierarchical structure of the industry's contractual framework makes it particular susceptible to the poor payment practices that it adopts. The wide range of parties involved in the construction process, the unequal commercial bargaining power of large as opposed to small companies and the cascading system of contracts among those parties meant that using contractual provisions to delay payment was easy.

Critics have also commented the construction industry for its out dated and inefficient payment practices resulting from an undesirable culmination of disputed and late payments and the uncertainty on when payment is due (Lip, 2006). Standard contract forms for the main contract do not explicit in payment provisions governing domestic subcontractors and suppliers. They do not have any protection against the financial risks inappropriately off-loaded upon them.

Also, there are no statutory legislation controls over the length of time that organizations could take to pay their suppliers and subcontractors, despite contractual provisions that set out payment entitlement (Pettigrew, 2005).

Security of payment problems is common in many commercial relationships, but the building and construction industry has special issues to deal with. With normal sale of goods, ownership does not transfer until payment is made. In construction work, things fixed to the land immediately become the property of the landowner. This means materials provided by a supplier may be incorporated into the works and become the property of the landowner well before payment is made for the materials (Gow P.W., 2006). It is too late to repossess of payment is not made.

Payment woes are made worse by growing affluence and higher quality expectations of purchasers or consumers (Lip, Eugenie, 2006). The consequence of this has spurred developers to stipulate longer defect liability periods and higher retention amounts. This inevitably translates to excessively large tied-up funds which for most are

the main contractor's life line.

The slow processing of variations and final accounts and difficulties in reaching settlement further add to the agenda of payment issues (Lip, Eugenie, 2005). Project personnel changes, poor documentation, no written instruction and incomplete or unavailable information are often cited as the reasons when pressured to bring the accounts to conclusion. Delay in finalizing variations and accounts serve no one's interest in time and expense (Lip, Eugenie, 2005).

2.1.3 Effects of Payment Problems on Construction Industry Development

The consequences of the factors as discussed as above combined with an unregulated payment system, led to the construction industry into the dilemma of payment-default. It is important to understand the structure of the construction industry and the way in which payment is distributed within a construction project in order to examine the effects of payment-default in construction industry. Generally, the distribution of payment within a construction project is distributed from the top of the pyramid to the bottom as illustrated in the form of a pyramid structure as figure below (Bayley G, 2006).

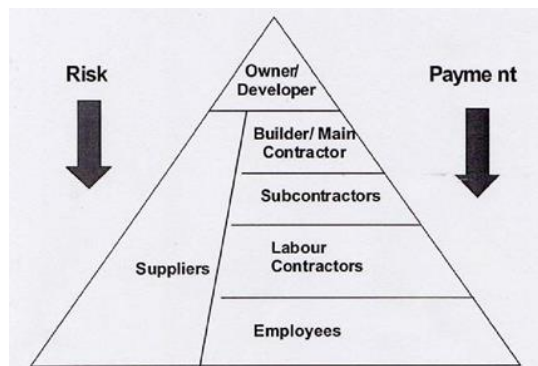


Figure 2.1: The Chain of Payment in Construction Industry

Source: Geoff Bayley, the New Zealand Construction Act 2002